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FM AMEMBASSY VILNIUS  
TO RUEHC/SECSTATE WASHDC 0988  
INFO RUEHZL/EUROPEAN POLITICAL COLLECTIVE  
RUCPDO/DEPT OF COMMERCE WASHINGTON DC

UNCLAS SECTION 01 OF 03 VILNIUS 000086

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E.O. 12958: N/A

TAGS: [EAIR](#) [EINV](#) [ECON](#) [PREL](#) [LH](#) [LG](#) [EN](#) [EUN](#)

SUBJECT: THE CURIOUS STATE OF LITHUANIA'S AIRPORTS

¶1. (SBU) Summary: Lithuania's main international airport in Vilnius is small, expensive, and inefficient, yet operates quite profitably. The airport, like Lithuania's air transport sector in general, has tremendous potential for growth, but the airport's management is oddly indifferent to it, and the GOL seems disinclined to force the issue. Low-cost carrier RyanAir has spurned Vilnius in favor of Kaunas's airport, which has seen its market share of Lithuania's passenger traffic increase by more than 450 percent in a year. The air transport sector will continue to grow, but in spite of the GOL's strategies, not because of them. End Summary.

Vilnius Airport: A Train Station with Planes?

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¶2. (U) Vilnius's tiny, four-gate airport (VNO) reminds one more of a well-kept train station than the main international airport serving a European capital city. The airport is less than five kilometers from the city center and the process of checking-in, going through security, and walking to a gate can take less than 10 minutes if one arrives at an off-peak time. Duty-free "shopping" consists of a few shelves along one wall displaying liquor, cosmetics, and chocolates. The only consumable food or drink available to passengers once they have passed through security comes from a couple of vending machines and a spartan cafe. The one reasonably high-quality amenity is the business-class lounge, a bargain at approximately USD 15 that includes leather couches, flat-screen televisions, wireless internet access, and unlimited drinks and snacks.

¶3. (U) Two airlines dominate VNO, which sees about 300 regularly scheduled flights per week in the winter and 320 in the summer. Riga-based AirBaltic, which began serving Vilnius less than three years ago, is now the market leader, with a market share of 32 percent. The privatized remnant of the former national airline, FlyLAL, has 29 percent of the market. Czech Airlines, British Airways, and Lufthansa all have single-digit shares of the market. No U.S. carrier flies to Vilnius.

Filled to capacity, kind of

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¶4. (SBU) VNO is a textbook model of how state ownership inhibits efficiency. An economy growing at more than seven percent per year and rapidly rising wages (nearly 16 percent in 2006) are increasing demand for air travel. Passenger traffic through VNO increased 13.2 percent in 2006 to 1.45 million, while the number of flights increased 0.5 percent to 29,300. The Director of Civil Aviation told us that the airport is operating at about 95 percent capacity in terms of its ability to process passengers, but at only about 60 percent in terms of its ability to handle aircraft traffic.

Expansion plans: Too little, too slow

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¶5. (SBU) Instead of investing heavily in expansion, however, the airport's leaders - who have worked at the airport since Soviet

times -- are loath to expand at a rate that can accommodate the increasing demand. The airport has chosen instead to focus on a necessary, but relatively modest, expansion of its terminal to allow it to meet its Schengen Treaty obligations, which require separate passenger-processing facilities for flights from non-Schengen countries. This expansion, scheduled for completion in September, will double the airport's capacity, allowing it to handle three million passengers per year.

¶16. (SBU) An AirBaltic executive told us, however, that within five years, this expansion will barely be able to handle the number of passengers that his company alone expects to serve, and complained that the airport's leadership has taken no steps to consider expansion beyond the current project. Frustrated by the airport's unwillingness to consider a more ambitious expansion, FlyLAL announced plans to build its own terminal by 2009 that will serve up to 1.5 million passengers, a project that the AirBaltic executive told us his company is likely to join. The airport's management, citing FlyLAL's debts to the airport, initially blocked the plan and refused to allow FlyLAL's contractors to enter the premises. FlyLAL sued the airport and won a favorable decision in late December 2006, enabling the first phase of the project to move forward.

¶17. (U) Even the GOL's Minister of Transportation (who ultimately shares the blame for the situation -- see para 14) has chided the lack of vision by those in charge of developing the airport. According to press reports, he told a group of MPs in November 2006 that the expansion of the terminal "should have started earlier" and that it "could be bigger."

Opportunity missed?  
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¶18. (SBU) As recently as 2003, VNO was the largest of the three Baltic airports, serving nearly 720,000 passengers to Riga's (RIX)

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711,000 and Tallinn's (TLL) 716,000. Since then, VNO's passenger traffic has doubled. TLL, however, has increased its passenger flow by nearly 125 percent, while RIX's volume surged 273 percent, making it easily the largest of the Baltics' airports (2.7 million pax in 2006). Tallinn now has the region's second busiest airport (1.6 million pax in 2006), even though Lithuania is nearly 2.5 times more populous than Estonia.

Bullish on growth  
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¶19. (SBU) AirBaltic's General Manager for Lithuania told us that the ratio of passengers to population (pax/population, roughly the number of flights taken by each citizen per year) in Lithuania, when compared with the other Baltics, suggested that the Lithuanian air transport sector has plenty of opportunities for growth. He said that the pax/population ratio for Estonia in 2006 was 1.19 and 1.15 in Latvia. The ratio for Lithuania, in contrast, was a mere 0.42, indicating that there is a tremendous potential for growth in the Lithuanian air transport sector, even before factoring in the impact of rapidly rising wages and strong economic growth.

An expensive place to do business  
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¶10. (SBU) For all its faults, VNO manages to make money hand over fist. The airport recently announced a profit of approximately USD 6.8 million for 2006, down from the USD 8.6 million profit the airport earned in 2005 on revenues of just under USD 39 million (a profit margin of more than 22 percent). Potential investors need not apply, however, as Lithuania's "Law on Strategic Enterprises and Assets" requires the state to maintain 100 percent control of all three of Lithuania's airports.

¶11. (SBU) Although the management of VNO told us that the airport's fees are "not particularly high," information from both industry and publicly available sources indicates that VNO's fees are the highest -- by far -- in the Baltics, and among the highest in the EU. AirBaltic told us, for example, that a Boeing 737-500 with 100

passengers would pay 621 percent more in landing and passenger fees in Vilnius than it would in Riga. A Fokker-50 with 40 passengers would pay 510 percent more in Vilnius. AirBaltic receives a significant discount on the fees it pays in Riga (up to 80 percent on landing fees, for example). Even without these discounts, however, a plane landing at RIX would pay less than 75 percent of the fees it would pay in Vilnius. Fees in Tallinn are about 60 percent of those at VNO.

#### Other options

¶12. (SBU) Vidmantas Kairys, the director of Lithuania's Civil Aviation Department, told us that there are three main possibilities for the future of Lithuania's main international airport: an expansion of VNO, converting the airport in Kaunas (one hour from Vilnius by car) into Lithuania's main airport, or building a new airport somewhere between the two cities. Kairys told us in November that the GOL is still considering all of these options and will announce the terms of reference for a tender early in 2007 that will call for bids to conduct a feasibility study to study the three options.

¶13. (SBU) Kairys said that expanding VNO is still a serious option. Although many Lithuanians believe that VNO is unable to expand because of its proximity to the city, both Kairys and AirBaltic said that VNO's most pressing limitation is its ability to process passengers, not the size of the airport itself. Kairys emphasized that VNO's current runway capacity was adequate for the airport to double or triple the number of passengers serviced. AirBaltic told us that the only significant improvement VNO needed beyond a more efficient and larger passenger terminal is a runway extension that would allow the airport to install equipment permitting aircraft to land when there is fog, a phenomenon that seriously affects VNO's operations approximately four weeks per year. The airport's management told us that it also supports this project and is currently conducting a feasibility study.

#### What can be done?

¶14. (SBU) None of our interlocutors had much positive to say about VNO's management; the adjective we heard most often was "Soviet." One industry executive told us that VNO's management appeared to be more interested in the company choir than in managing the airport's potentially bright future. A mid-level Civil Aviation Department official told us that the Ministry of Transportation does not have the authority to replace the airport's management, explaining that doing so was a complex process controlled, at least in part, by the State Property Fund, which technically owns the airport on behalf of the Lithuanian Government. He said that the Ministry of

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Transportation, recognizing the growth potential of Lithuania's air transport sector, has been taking a very serious look at VNO's operations, and it was clear that he was familiar with complaints about VNO's management. He was, however, non-committal when we asked if replacing VNO's management was high on the Ministry's agenda.

#### Lithuania's new number two airport

¶15. (U) Historically focused mainly on cargo flights, Kaunas International Airport (KUN) processed fewer than half the number of passengers of the tiny airport in Palanga until low-cost carrier Ryanair began flights to Kaunas from London in September 2005. Since then, the number of passengers using KUN has more than tripled (to 250,000 in 2006), as Ryanair added routes to Stockholm, Dublin, Liverpool, and Frankfurt-Hahn from KUN. KUN's share of the domestic market swelled from 2.5 percent to 13.8 percent in 2006, easily making it the second busiest airport in Lithuania. KUN officials told us that Ryanair wants to continue to grow its presence at the airport, and make it an important operational and maintenance hub for its fleet.

¶16. (SBU) KUN officials jumped at the chance to work with Ryanair and have offered discounts on fees up to 86 percent for airlines serving more than 200,000 passengers per year. VNO's management, in contrast, told us that it had "no interest" in working with low-cost carriers or offering any incentives to entice additional carriers.

¶17. (SBU) KUN's management also told us that they would like to attract a U.S. carrier to fly directly to Kaunas from the United States, claiming that they had research suggesting that the market could support three direct flights per week. (We have passed an introductory letter from KUN to the Air Transport Association of America.)

Comment  
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¶18. (SBU) Lithuania's air transport sector is ready to take off with or without the cooperation of VNO's management. The GOL, which clearly recognizes the growth potential of the sector, is nonetheless doing little to press the issue with any urgency. One option, privatizing the airports, is not a possibility at present because the airports are considered "strategic assets" under Lithuanian law, which prevents them from going private. Replacing VNO's management would be a good (and seemingly obvious) place to start; the Ministry of Transportation's seeming reluctance to push this issue suggests a lack of a vision and interest. Despite this suboptimal policy environment, this sector will remain a significant growth industry in Lithuania.

KELLY